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*Economic Policy Reform and  
Competitiveness Project*

# Review of regulations, policies and procedures for approval, listing and supervision of initial public offerings of securities in Mongolia

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Main Author: Cliff Kennedy  
Contract No. 438-C-00-03-00021-00  
Submitted by: EPRC Project/Chemonics International Inc., Tavan Bogd Plaza, Second Floor, Eronhii Said Amar Street. Sukhbaatar District, Ulaanbaatar, Mongolia  
Telephone and fax: (976) 11 32 13 75 Fax: (976) 11 32 78 25  
Contact: Fernando Bertoli, Chief of Party  
E-mail address: fbertoli@eprc-chemonics.biz



## **ABBREVIATION AND ACRONYMS**

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AMF	Autorité des marchés financiers
DCF	Discounted Cash Flow
EPRC	Economic Policy Reform and Competitiveness Project
FRC	Financial Regulatory Commission
IOSCO	International Organization of Securities Commissions
IPOs	Initial Public Offerings
MD&A	Management Discussion and Analysis
MICC	Mongolian International Capital Corporation
MoF	Ministry of Finance
MSE	Mongolian Stock Exchange
OTC	Over-the-Counter
SEC	Securities and Exchange Commission
USAID	United States Agency for International Development



## TABLE OF CONTENTS

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ABBREVIATION AND ACRONYMS .....	i
EXECUTIVE SUMMARY .....	3
SECTION I: APPROACH TO REVIEW .....	7
SECTION II: PRESENT IPO REGULATIONS, POLICIES AND PROCEDURES IN MONGOLIA AND INTERNATIONAL BEST PRACTICE .....	9
A. Initial public offerings of securities .....	9
B. Disclosure to Potential Investors .....	11
C. Underwriting and due diligence .....	14
D. Valuing or pricing IPOs .....	15
E. Review of disclosure documents.....	15
SECTION III: RECOMMENDED CHANGES TO IPO REGULATIONS POLICIES AND PROCEDURES.....	17
ANNEX A: DISCLOSURE REQUIREMENTS IN THE IPO REGULATION.....	23
ANNEX B: DOCUMENTS REVIEWED .....	43
ANNEX C: MEETINGS .....	47
ANNEX D: PRESENTATION SLIDES .....	51



## EXECUTIVE SUMMARY

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The objective of the consultancy was to review the existing regulations, policies and procedures related to the approval of Initial Public Offerings (IPOs) by the Financial Regulatory Commission (FRC) and their listing and supervision on the Mongolian Stock Exchange (MSE) and to recommend (1) revisions to align these regulations, policies and procedures with best international practice, and (2) capacity building initiatives for MSE and FRC staff to ensure efficient and transparent approval, listing and supervision of IPOs.

FRC was established in 2006 to “ensure the stability of the financial markets, regulate financial services, monitor the implementation of the relevant legislation, and protect the rights of investors and clients of the financial markets.”<sup>1</sup> FRC has had its responsibilities grow substantially in recent years. This is partially a result of a substantial increase in the number of licensed market participants and the number of listed companies at the MSE. FRC’s responsibilities include supervising the MSE, the Central Depository and Clearing House, 41 brokerage and dealer companies, and 10 underwriting companies. All regulation of market participants falls under FRC as there are no Self Regulatory Organizations (SRO). At the start of 2008, FRC had regulatory oversight for 364 Listed Companies (25 state-owned, 43 mixed ownership, and 322 private companies).

Article 7 of The Securities Market Law of Mongolia (Securities Law) empowers FRC to authorize the issue of securities by issuers, including IPOs. Accordingly, FRC examines the applications for issues of shares and bonds, performs an internal analysis, issues approval, organizes registration and determines whether reports and other mandatory information submitted by issuers are in compliance with laws and other regulations. Three FRC staff are assigned to processing of IPOs.<sup>2</sup>

Although the FRC issued regulations for the IPO market in 2006, the FRC has not updated its regulations or prepared general guidelines or instructions to be followed by an issuer interested in publicly selling their shares. As a result, the IPO preparation and review process is time consuming taking as much as four months to complete. The FRC reviewed 2 IPO applications in 2005, 2 in 2006 and 4 in 2007. Since the beginning of 2008, IPO applications from 12 companies have been pending or under review by FRC staff.

When compared to international standards, including IOSCO, the EU Prospectus Directive, and SEC regulations and written guidance, the Mongolian IPO regulatory scheme is in its infancy and requires considerable development in order attract domestic and foreign investors.

As of this writing, FRC is preparing a revised set of IPO regulations. In that connection, particular attention should be paid to the IOSCO standards. FRC has been an IOSCO member since 2002 and is a member of IOSCO’s Asia Pacific Regional Committee and its Emerging Markets Committee.<sup>3</sup> IOSCO has developed detailed disclosure standards applicable to equity securities and substantive disclosure principles for documents used in public offerings and

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<sup>1</sup> Law on the Legal Status of the Financial Regulatory Commission, Article 4.1. Some of the new FRC responsibilities in the securities market include: market and exchange supervision, monitoring of disclosure requirements for securities, setting up a data base in this context, monitoring of disclosure requirements of listed companies, surveillance of listed companies with respect to disclosure requirements, stock exchange supervision in the sense of market supervision, and market abuse surveillance for insider trading and market manipulation.

<sup>2</sup> Two are lawyers, one is an economist.

<sup>3</sup> The IOSCO securities disclosure and prospectus standards are set forth and discussed in several releases: IOSCO International Disclosure Principles for Cross-Border Offerings and Listing of Debt Securities, October 2005; IOSCO International Disclosure Standards for Cross-Border Offerings and Initial Listings, September 1998.

listings of corporate debt securities. Recently, the IOSCO disclosure standards were adopted by the US SEC in revisions to its foreign issuer disclosure requirements. Similarly, the French AMF allows Non-EU issuers to file a prospectus that complies with IOSCO disclosure standards.

In summary, the report finds that the disclosure requirements for initial public offerings included in the Securities Law and the IPO Regulation are considerably short of meeting international standards. Additionally, the procedures for the approval, listing and supervision are not sufficient to provide guidance to issuers and underwriters to manage the IPO preparation process. This results in substantial processing time being required by issuers and underwriters to complete IPO applications and prospectuses to obtain FRC approval.

Section I of this report sets out the approach to the review, Section II reviews current regulations, policies, procedures and practices and international best practice and Section III sets out changes that should be made to the regulations, policies and procedures. The highlights of the recommendations are:

**Improved disclosure standards.** These should be based on existing disclosure standards of IOSCO, the European Union, and the SEC applicable to equity securities and substantive disclosure principles for documents used in IPOs, secondary public offerings and listings of securities.

**Short Prospectus for potential investors.** It would serve the public interest to require that the issuer prepare a Short Prospectus and make it available for potential IPO investors. The Short Prospectus should be “reader friendly”, provide summary information about the issuer, risk factors and other important matters, and be provided to all those filling out an application forms to purchase IPO securities.

**Requirement of Management Discussion and Analysis in Financial Reports.** The inclusion of Management Discussion and Analysis (MD&A) in financial reports has become an international standard. MD&A provides information about the components of a company’s earnings and cash flow and helps make sense of complex financial statements and risk factors. Such disclosure of management’s assessment of factors and trends which are anticipated to have a material effect on the company’s future financial condition and operations enables investors to look at the company through the eyes of management. The revised FRC IPO regulations should consider this requirement.

**Prospectus dissemination.** There is no substantial dissemination of information in a public offering in Mongolia. To address this lack of information dissemination, draft prospectus and the final prospectus could be placed on the FRC’s web site and kept there until the offering is completed. In addition, prospectuses should be available from the FRC, the MSE, the underwriter, and the company.

**Due diligence.** The conduct and practice of proper due diligence by underwriters needs to be improved. The underwriter must investigate enough to be assured that it has a firm grasp on the business and affairs of an issuer so that it can offer and sell securities with confidence that its customers have been fully apprised of the legal, financial and business position of the issuer. The FRC should take steps to have the underwriter perform such proper due diligence of the issuer.

**Procedural changes.** The FRC should consider extensive use of instructions, circulars, releases and other measures to improve IPO processing at the FRC. The use of a regulatory check list will not be sufficient to increase the efficiency of the IPO review process. Interviews in the financial community indicated that more written guidance, clarification, and streamlining of procedures are required from the FRC.

**Integration of private offerings.** Under Mongolian law, an offering to fewer than 50 people is a private offering and such offerings are not subject to the detailed disclosure requirements applicable to public offerings. At this time, there is no prohibition against a company making a series of private offerings, even though only a short time has elapsed between offerings, thus avoiding the disclosure requirements for public offerings. FRC should adopt the concept of integration to prevent this abuse.

**FRC staff training.** It is also recommended that FRC establish a formal training program for its professional staff in charge of reviewing IPO applications and prospectuses. To that effect, the FRC should consider development of a procedures manual and a training manual for such staff.



## **SECTION I: APPROACH TO REVIEW**

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The review and discussion in this Report relate to those sections of the IPO Regulation that pertain to initial public offerings, which together with relevant sections of the Securities Law, Company Law and MSE Listing Rules, are the existing regulations, policies and procedures related to approval of IPOs by the FRC. The sections of the IPO Regulation include Chapters 1-3 and 7 and Annex 1 and 2, consisting of:

- Chapters One- General Provisions
- Chapter Two- Documents to be Filed For a Listing of Securities Issued for a Public Offer
- Chapter Three- Approval of Securities Listing and Trading
- Chapter Seven- Public Disclosure of Securities Prospectus and Information
- Annex 1- Application to List Securities Issued For a Public Offer
- Annex 2- Brief (Short) Prospectus on Securities Issued for a Public Offer

The preparation of this report included a review of the present disclosure requirements included in the IPO Regulation, the manner in which disclosure documents were processed at the FRC and the way the disclosure documents were disseminated. Most of the information used in preparing this report was obtained from meetings with staff members of the FRC, the MSE and market participants. Meetings were also held with other stakeholders involved in disclosure activities such as accountants, investors and publicly traded companies.

The review of the existing IPO registration process in Mongolia was conducted to gain an understanding of:

- The requirements for approval and listing of initial public offerings of securities.
- The registration and application procedures and process for companies, licensed securities dealers, underwriter and other relevant stakeholders to follow to obtain IPO authorization from the FRC and MSE.
- The FRC process for reviewing applications, prospectuses, and documents to assure compliance with regulatory requirements.
- The FRC methodology for regulating the IPO process and to develop recommendations to align the FRC and MSE regulations, policy and procedures for the approval and listing of IPOs with best international practices.

Interviews of market participants and issuers were conducted to determine how the present system is viewed by the participants in the system. The term system is used to refer to the rules, regulations, practices and traditions that determine the disclosures made by new public or listed companies in Mongolia and the manner and extent issuer information is disseminated to prospective public investors. The participants in the system include not only the FRC, but also the MSE, underwriters, listed companies, accountants, and public investors who are the users of issuer generated disclosure.

A number of documents were reviewed for background information, including a completed and FRC approved prospectus for the ANOD Bank IPO. A list of these documents may be found in Appendix A. Most of the information needed for the review was obtained through meetings with various people at the FRC, MSE, market participants and other organizations responsible for disclosure activities. A list of the people who participated in meetings may be found in Appendix C. All individuals interviewed were extremely informative and cooperative and very patient in answering questions and explaining their system in detail.

The meetings with the FRC staff provided an understanding of:

- The FRC IPO Regulation, process and procedures.
- Use of the IPO application, prospectus, attachments and documents
- Review and processing of IPO applications, prospectuses and documents by FRC staff
- Traditional methods of offering securities in Mongolia
- The share pricing and book building processes
- Retail marketing through the IPO process
- Oversight of the IPO process by FRC through the offer, sale and reporting periods
- FRC and MSE use of their oversight authority and power to set disclosure standards in IPOs and for listed companies

Meetings with staff members of the MSE provided information regarding MSE involvement in the IPO process and on the semi-annual and annual reporting system for listed companies and the ways in which the FRC and the MSE makes these reports available. The MSE meetings also provided a better understanding of the reporting of material information by companies and the methods used by the MSE and the FRC to try to improve issuer compliance with the IPO process and issuer reporting requirements.

Additionally, a number of licensed investment advisers and underwriting firms explained their role in the IPO process and provided information on how required disclosure documents are prepared and used in the IPO application and distribution process.

The discussions with an officer at Anod Bank involved in the marketing of the IPO provided the point of view of a “regulated issuer” with respect to disclosure requirements made in IPOs.

To summarize the findings and conclusions and to discuss the recommendations of the consultancy, a Power Point presentation was prepared and presented to the FRC and market participants. A copy of the slide presentation is attached in Appendix D.

## **SECTION II: PRESENT IPO REGULATIONS, POLICIES AND PROCEDURES IN MONGOLIA AND INTERNATIONAL BEST PRACTICE**

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### **A. Initial public offerings of securities**

In market based economies companies are initially funded by raising equity capital from a small number of investors, with no public liquid market existing if these investors wish to sell their stock. If a company prospers and needs additional equity capital, at some point the firm generally finds it desirable to "go public" by selling stock to a large number of diversified investors. Once the stock is publicly traded, this enhanced liquidity allows the company to raise capital on more favorable terms than if it had to compensate investors for the lack of liquidity associated with a privately-held company.

An initial public offering occurs when securities of a privately held company, after registering with a securities regulator, are sold to the general public for the first time, usually through an underwriter, with the expectation that a liquid market will develop in the shares. With these benefits, however, come costs. In particular, there are certain ongoing costs associated with the need for a publicly traded company to supply information on a regular basis to investors and regulators after the completion of the IPO.

Furthermore, there are considerable one-time costs associated with an IPO that include the legal, auditing, and underwriting fees. Indirect costs include the management time and effort devoted to conducting the offering, and the dilution associated with selling shares at an offering price that is, on average, below the price prevailing in the market shortly after the IPO. These costs affect the cost of capital for firms going public.

In going public, an issuing firm will typically sell 20-40 percent of its stock to the public. In the US, EU countries and other jurisdictions following international standards, an issuer will hire underwriters to assist in pricing the offering and marketing the stock. In the US, in cooperation with outside counsel, the underwriter will also conduct a due diligence investigation of the firm, write the prospectus, and file the necessary documents with the SEC. Very similar practices are followed in the French securities market, which is regulated by the AMF.<sup>4</sup>

For young companies, most or all of the shares being sold are typically newly-issued (primary shares), with the proceeds going to the company. With older companies going public, it is common that many of the shares being sold come from existing stockholders (secondary shares).

An issuer will generally choose a lead underwriter on the basis of its experience, especially with IPOs in the same industry. Having a well-respected analyst who will supply research reports on the firm in the years ahead is a major consideration.<sup>5</sup>

In the US, SEC clearance is needed to sell securities to the public. The regulations are based upon a securities law, but in practice much case law and professional judgment applies. Although the SEC is explicitly concerned with full disclosure of material information, it does not attempt to determine whether a security is fairly priced or not. In preparation for going public, a company must supply audited financial statements. The level of detail that is required depends upon the size of the company, the amount of money being raised, and the age of the company. The required disclosures are contained in SEC Regulations S-K or S-B (covering the

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<sup>4</sup> The French securities market is regulated by the Autorite des Marches Financiers (AMF).

<sup>5</sup> Investment bankers with large market shares of IPOs include Goldman Sachs and Merrill Lynch.

necessary descriptions of the company's business) and Regulation S-X (covering the necessary financial statements). It takes at least several months to complete the process of going public.

After the preliminary prospectus is issued, the company management and underwriter conduct a marketing campaign for the stock. Regulations limit what can be said in this marketing campaign. This marketing effort includes a "road show" to major cities, in which presentations are made before groups of prospective institutional buyers as well as in one-on-one discussions with important IPO buyers, such as mutual funds. If the offering is sufficiently large and has a portion of the offering set aside for international buyers, the road show may include presentations in Europe and Asia.

In Mongolia, by way of the Securities Law and OTC Regulation, the FRC has jurisdiction over the public offering of securities by issuers making their initial public offering and listed companies raising additional funds through offering or otherwise. The Securities Law prohibits an issuer and professional market participants from offering to sell (their) securities to the public or to advertise the sale prior to the FRC making a decision to register those securities.<sup>6</sup> The FRC also has direct jurisdiction over the semi annual, annual financial statement and balance sheets disclosure obligations<sup>7</sup> of listed companies, also referred to as public companies.

FRC issued the Regulation on Listing of Securities Issued for Public Offering (IPO Regulation) in 2006, establishing the requirements for making a public offer of securities, including the role of the underwriters in the exchange listing and offering process<sup>8</sup> and the information that must be furnished in an application and prospectus with the FRC. While the regulation requires the inclusion of audited financial statements, the Ministry of Finance establishes the accounting standards for the preparation of such statements.

The existing regulatory framework for registration of securities includes the Securities Law and the IPO Regulation, which includes several form attachments. To obtain authorization to issue securities, a company must complete and submit to the FRC an application to list securities, a prospectus on the securities issuer and securities to be issued and other documents that meet the requirements of the Securities Law and IPO Regulation.<sup>9</sup> There are no written FRC procedures or guidelines for the IPO process.

As the initial step, an issuer intending to make a public offering of its securities files an application and prospectus with the FRC.<sup>10</sup> The IPO Regulation requires the application be drafted in accordance with the sample adopted as Annex 1 of the IPO application. The regulation requires FRC must review the application, prospectus and other documents from the issuer within thirty days and make its decision whether the issuer meets the regulatory requirements.<sup>11</sup> However, the issuer usually amends its filing a number of times which usually delays the FRC decision for three to four months.<sup>12</sup> An issuer has one year to complete its offering after the FRC approves the application.<sup>13</sup>

Section 7 of the IPO Regulation and various provisions of Sections 8 and 9 of the Securities Law set forth the general requirements for the distribution and offering and selling of an

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<sup>6</sup> Securities Law, Sections 16.1 and 16.1.7; see Section 38 regarding penalty provisions

<sup>7</sup> Securities Law, Sections 10.1.3 and 10.1.4

<sup>8</sup> IPO Regulation, Section 2.7.17; Securities Law, Section 9.2

<sup>9</sup> IPO Regulation, Section 2.1; the Regulation requires two copies by filed that includes an original.

<sup>10</sup> IPO Regulation, Section 2.1

<sup>11</sup> IPO Regulation, Section 3.1; Securities Law, Section 7

<sup>12</sup> IPO Regulation, Section 3.3; Section 7.10 of the Securities Law sets forth the basis for FRC refusal to register the issue, which may be appealed to the Court by the issuer pursuant to Section 7.11.4

<sup>13</sup> Securities Law, Section 9.8; also see IPO Regulation, Sections 3.13 and 3.14

issuer's securities after the application and prospectus is authorized by the FRC. After first complying with the comments received from FRC, the issuer will make the prospectus available for public disclosure as set forth in the IPO Regulation<sup>14</sup> and Annex 2 of the Regulation by making a copy available at the office of the issuer and at the FRC.<sup>15</sup> Possible purchasers of the IPO securities in a public offering are solicited following the direction of the IPO Regulation.<sup>16</sup> Although a short form prospectus<sup>17</sup> may be prepared by an issuer, it is not required to be provided to a prospective purchaser or purchaser of the IPO securities.

After the FRC authorizes the offering, IPO selling activity takes place at MSE through the underwriters and member brokers. A securities transaction report is provided to FRC within 30 days of the completion of the offering.<sup>18</sup> If information included in the issuer's report meets regulatory requirements the FRC registers the issued securities.<sup>19</sup>

## **B. Disclosure to Potential Investors**

The FRC has the authority to set the disclosure requirements for the documents used in connection with initial public offering of securities; requirements are set forth in the Securities Law<sup>20</sup> and the IPO Regulation and are divided into three sections. One section sets forth the disclosure requirements for the prospectus;<sup>21</sup> another section sets forth the disclosure requirements for an Application, which must be written in accordance with Annex 1 of the IPO Regulation;<sup>22</sup> and a third section sets forth the requirements in any relevant documents filed, which are not specifically listed or identified in the Regulation.<sup>23</sup>

Specific regulation requirements are brief and vague and no guidelines or instructions are provided by the FRC to help and assist during the process of preparing an Application or Prospectus. Without furnishing written instructions for the information required, Part Two of the IPO Regulation, states that, among other requirements, the following information and documents must be furnished to the FRC in connection an application and draft prospectus. This is a list of the most significant information the FRC requires in the IPO Application that must be furnished by an issuer:

- Background on the issuer of securities, type of activities, strategy, primary benchmark of production and services, information on the position of the issuer of securities in the specific market, and research (Section 2.6.1)
- Prospectus on organization of the issuer of securities, governing structure, and representative offices and unites (Section 2.6.2)
- Type and form of securities being offered (Section 2.7.1)
- Risk and risk analysis that may occur to investors when purchasing specific securities (Section 2.7.14)
- Estimation for price of offering (Section 2.7.8)
- Business plan of the company (Section 2.7.12)

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<sup>14</sup> IPO Regulation, see Sections 7.1 through 7.4 regarding the public disclosure of a securities prospectus and information.

<sup>15</sup> IPO Regulation, Section 7.2

<sup>16</sup> See Sections 7.1 through 7.4

<sup>17</sup> IPO Regulation, Section 7.2

<sup>18</sup> See Section 9.6 of the Securities Law.

<sup>19</sup> Securities Law, Section 9.7

<sup>20</sup> Securities Law, Sections 7.1-7.4; Section 7.4.9 also authorizes the FRC to require "other information"

<sup>21</sup> IPO Regulation, Sections 2.3-2.8

<sup>22</sup> IPO Regulation, Section 2.2

<sup>23</sup> IPO Regulation Sections 2.1,2.3, 2.4, and 2.5

- Stock market data (Section 2.7.5)
- The terms of the particular offering, including type and form of securities (Section 2.7.13)
- Entitlements of the securities owner (Section 2.7.2)
- The identity and contract terms of any underwriter (Section 2.7.17)
- The procedure and plan to trade securities of public disclosure, including if done without an underwriter (Section 2.7.17)
- Information on previous issues of securities and bond information (Section 2.7.7)
- The use of proceeds (Section 2.7.11), and
- Financial reports of the issuer for the last three years, including complete additional explanations and clarifications as specified in identified Regulations of the FRC and MOF, are required to be included with the application documents and the company, as well as the financial report of the quarter prior to the application of approval to list securities certified by an auditing organization (Section 2.6.5).

Many of these identified requirements are generally in line with international standards. Although some of the requested information is easily understood, no explanations, clarifications or identified details required are specified in the IPO Regulation regarding the requested information.

In most markets, a securities regulator will establish a regulation that is descriptive and easily understood and develop practice rules, instructions, circulars, releases, and opinion letters and release or publish prospectus and application comment letters to the public. Many filed applications and prospectuses are now available on the websites of most regulators, including the SEC and all EU member countries. Filed prospectuses are a helpful resource during the filing preparation stage of an offering.

In addition to the specific disclosures listed and described in its Regulations, most countries rely on an overriding principle that, in connection with a registration or listing of securities or a public offering of securities, a company should disclose all information that would be material to an investor's investment decision and that is necessary for full and fair disclosure. Thus, information called for by specific requirements in Mongolia under the IPO Regulation needs to be expanded under this general principle, where supplemental information is deemed to be material to investors and necessary to keep the mandated disclosure provided pursuant to specific requirements from being misleading.

In order to support the effort to make sense of complex financial statements and risk factors, the inclusion of **Management Discussion and Analysis (MD&A)** in financial reports has become an international standard. IOSCO has noted that corporate financial collapses in the first few years of the twenty-first century “highlighted the need for improved disclosure and transparency” and the MD&A “provides a context within which financial statements can be interpreted.” According to IOSCO, the MD&A provides information about the components of a company’s earnings and cash flow. Such disclosure of management’s assessment of factors and trends which are anticipated to have a material effect on the company’s future financial condition and operations enables investors to look at the company through the eyes of management.<sup>24</sup> Accordingly, the development of MD&A disclosure should begin with management's identification and evaluation of what information, including the potential effects of known trends, commitments, events, and uncertainties, is important to providing investors

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<sup>24</sup> Paragraph (a) of Item 303 of Regulation S-K identifies a basic and overriding requirement of MD&A: to "provide such other information that the registrant believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations."

and others an accurate understanding of the company's current and prospective financial position and operating results. Management should provide the most relevant information and provide it using language and formats that investors can be expected to understand.

Although there is no disclosure of the filed application and prospectus by the issuer or by the FRC,<sup>25</sup> the IPO Regulation requires the FRC to publicly disclose the offered securities on its website and through media outlets.<sup>26</sup> The regulation does not require that a copy of a prospectus be filed with the MSE or provided to prospective purchasers. It is usually the case that purchasers of securities in the IPO process do not receive the disclosure information vetted through the FRC.

A critical requirement regarding furnishing important summary information to prospective investors through the creating and use of a short or brief prospectus is briefly addressed in Section 7 of the IPO Regulation;<sup>27</sup> the key regulation is based on the Securities Law disclosure requirement by an issuer to prospective purchasers of their securities.<sup>28</sup> However, in its OTC Regulation, the FRC proposes but does not require that a completed Annex 2 document be used in the solicitation of prospective public investors. Several members of the investment community, including employees of FRC, believe that there is a substantial difference in the disclosure available to Issuers and underwriters and the general public, with respect to companies on a continuous basis. First of all the disclosure required in semi-annual and annual report is very limited. Even though some reports are filed with the FRC and the MSE and under some conditions put on the FRC web sites, it is not reasonable to assume that members of the public have access to these web sites or filed information and reports. Except for noting that regularly required reports are filed, no real review of the contents of these reports is made by staff members at the exchanges.

Securities companies can and do visit companies and meet with management and obtain all the information they want and need in order to make an investment decision. Some believe they can even overcome the problem of inadequate accounting standards, because of their ability to examine the records themselves. Some of the larger companies, particularly those who are interested in attracting international investors, voluntarily furnish more information in their annual reports than is required. Because of the absence of specific disclosure requirements in these reports, there is no assurance that the additional disclosures are complete and balanced.

It would serve the public interest for the Regulation to require that the **Short Prospectus** be given to investors when they are solicited to purchase IPO securities in Mongolia. The completion and use of the Short Prospectus is very informative and helpful when the information in the application is substantial and when the length or complexity of the prospectus makes a summary useful. Such a provision is included in SEC regulations that could be adopted and applied to the Mongolian situation. The SEC regulation and Instruction requires an issuer prepare a summary prospectus that furnishes summary information about the issuer, risk factors and other matters.

There is no substantial dissemination of information in a public offering in Mongolia. Steps can be taken to change this situation by requiring that draft prospectus and the final prospectus are placed on FRS's web site and the final prospectus remains there until the offering is

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<sup>25</sup> A number of jurisdictions will make an application, prospectus or registration statement public on their website. As a result, for example, in India the securities regulator will sometimes receive information regarding incomplete or misleading disclosure in the prospectus.

<sup>26</sup> IPO Regulation, Section 7.5

<sup>27</sup> OTC Regulation, Sections 7.1-7.3

<sup>28</sup> Securities Law, Sections 8.1 and 8.2; authorizes the FRC to determine the procedure on disclosure of introductory information on issuing of securities.

completed. In addition, prospectuses should be available or obtained from FRC, from the MSE, from the underwriter and from the company.

### **C. Underwriting and due diligence**

In international markets underwriters play the most significant role in the issuance of securities. Underwriters function as the first line of defense with respect to material misrepresentations and omissions in the application and prospectus and other documents filed in connection with an IPO. Underwriters must exercise a high degree of care in investigation and independent verification of an issuer's representations during the preparation of the documents for the IPO, sometimes referred to as due diligence.

Generally, an underwriter has certain duties under professional standards, and liabilities under the securities laws. When the underwriter is aware of the existence of possible fraud or illegal acts concerning the prospective issuer, the underwriter should be satisfied that such matters have been adequately disclosed in the registration statement or prospectus.

If concerns as to possible fraud or illegal acts have not been resolved prior to a proposed securities offering, the underwriter must consider whether (1) it is appropriate to be associated with such proposed securities offering, (2) the underwriter should refuse to consent to the use of his or her report on the company's financial statements, and (3) the underwriter should refuse to issue a comfort letter.

In the US markets underwriters conduct their work knowing that US law provides that an underwriter could be liable if any part of a registration statement or prospectus contains material omissions or misstatements. Specifically, every underwriter with respect to a security may be sued by any person acquiring that security if any part of the registration statement or prospectus contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading.<sup>29</sup> There is no comparable provision in Mongolian law at this time.

In Mongolian underwriting, the concept of due diligence is a new concept that should be introduced by the FRC. The underwriter must investigate enough to be assured that the underwriter has a firm grasp on the business and affairs of an issuer that enables the underwriter to offer and sell securities with confidence that its customers have been fully apprised of the legal, financial and business position of the issuer.

Typically in developed markets an underwriter engages a law firm to assist in the due diligence process. The law firm is assigned the task of conducting the legal due diligence. At a minimum, this is a review of all material and business documents contracts and agreements. Beginning with the basic incorporation documents, the law firm will review loan documents, bank and other financing documents, contracts, leases and agreements material to the business. In appropriate situations, title reports and environmental surveys may be requested for significant real property owned by the company. The legal review is a key element of the due diligence process and an underwriter should have the greatest confidence in the legal counsel selected for this task.

A second level of due diligence is the financial analysis. This is a thorough review and dissection of the issuer's financial statements, books and records, including its tax returns. The outside accounting firm engaged by the company is debriefed, questioned and challenged, not in an adversarial manner, but to obtain insight into the level of review or audit conducted by

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<sup>29</sup> Securities Act of 1933, Sections 11 and 11(a)

the outside accountant and an explanation of the various accounting principles relied upon to prepare financial statements and reports.

The third key element of a due diligence review is an understanding of the business of the company and the industry in which it operates. This is perhaps the most significant area of due diligence. For an underwriter to have fulfilled its due diligence obligations, it should be thoroughly familiar with the business of the company and its industry.

#### **D. Valuing or pricing IPOs**

International best practice mandates that neither the securities regulator nor the government establishes or has a role in establishing the offer price.<sup>30</sup>

Most issuers involved in an IPO use either a firm commitment or best efforts contract with their underwriter.<sup>31</sup> With a firm commitment contract, a preliminary prospectus is issued containing a preliminary offering price range. After the issuer and its underwriter have conducted a marketing campaign and acquired information about investor willingness to purchase the issue, a final offering price is set. The final prospectus is then issued, and when the regulator clears the offering, the IPO goes “effective”. Importantly, the underwriter must sell all of the shares in the issue at a price no higher than the offering price once this has been set.

With a best efforts contract, the issuing firm and its underwriter agree on an offer price as well as a minimum and maximum number of shares to be sold. A selling period then commences, during which the underwriter makes its best efforts to sell the shares to investors. If the minimum number of shares is not sold at the offer price within a specified period of time, usually 90 days, the offer is withdrawn and all investor monies are refunded from an escrow account, with the issuing firm receiving no money.

Although it is not clear how IPO pricing is determined in Mongolia, it is important to disclose the method by which the distribution price has been or will be determined and, if estimates have been provided, explain the process of determining the estimates.

A prospectus should be used for road shows and also in connection with book building. The FRC should publish a circular prohibiting the furnishing of any information in a road show that is not in the prospectus, which should help to assure that some purchasers of securities in a public offering do not have information that is not available to all purchasers.

#### **E. Review of disclosure documents**

The Securities Market Department of FRC is responsible the review of initial public offering documents. At this time there are six professionals who handle all of the Department’s responsibilities that include licensed market participants, listed companies, IPOs and all related regulatory matters. There is no structured training program for employees who will examine the disclosure documents; only on-the-job training.

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<sup>30</sup> SEC Chairman, William Donaldson, stated in December 2004 that the price of an offering should be determined by investor demand driven by normal market forces that include current and accurate detailed information about an issuer that has been disseminated to the public market on an ongoing basis in filings, the media and various websites, including the issuer, the stock exchange, the SEC and financial newspapers and television.

<sup>31</sup> Some companies sell their shares in an IPO without using an underwriter, especially small local companies. An advantage for an issuer is the possibility of reduced costs. Investors may be cautious, however, due to the lack of a third party underwriter using its reputation as regards due diligence and valuation.

When an IPO filing is made with the FRC an Application and Prospectus are furnished. The application and prospectus is distributed to two professionals in the Securities Markets Department. It is recommended that notice of the filing is also sent to other relevant departments in FRC, including the Investigation and Enforcement Department, to determine whether they have any information about the company.

The FRC staff reviews the documents for compliance. The lead underwriter is not required to provide a due diligence certificate confirming that the application and prospectus complies with all legal requirements and the disclosures are true, fair and adequate. The FRC staff could place a great deal of reliance on such a certification; however, the review is not just a check list review. The FRC staff does raise questions if the information appears incomplete or inconsistent.

Apparently the quality of the disclosure documents varies considerably, depending primarily on the experience of the underwriter or investment adviser. Not surprisingly the staff believes that the larger underwriters prepared better disclosure documents than the smaller ones.

If a company does not respond to comments received from the staff, FRC can deny the company the right to make a public offering. The certification of a lead banker could be suspended or revoked if that underwriter failed to assure that the company had fully complied with the disclosure guidelines.

Although members of the financial community (investment bankers, companies, exchange members) expressed different opinions with respect to the quality of the review given by the staff of FRC, almost all believed that the FRC review took too much time. Some persons felt that the questions and comments raised by the staff indicated that a thorough review was made. Others believed that the staff should provide much more written guidance about the Application and prospectus that would result in a shorter review period.

## **SECTION III: RECOMMENDED CHANGES TO IPO REGULATIONS POLICIES AND PROCEDURES**

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**Improved disclosure standards.** IOSCO, the European Union, the United States SEC have developed detailed disclosure standards applicable to equity securities and substantive disclosure principles for documents used in public offerings and listings of securities. Recently, the IOSCO disclosure standards were adopted by the US SEC in revisions to its foreign issuer disclosure requirements. Likewise, the French AMF allows Non-EU issuers to file a prospectus that complies with IOSCO disclosure standards.

Annex A sets out recommended wording to strengthen the disclosure requirements in the IPO regulation incorporated in Chapters 1-3 and 7, and Annex 1 and 2, which include:

- a. Chapters One- General Provisions
- b. Chapter Two- Documents to be Filed for a Listing of Securities Issued for a Public Offer
- c. Chapter Three- Approval of Securities Listing and Trading
- d. Chapter Seven- Public Disclosure of Securities Prospectus and Information
- e. Annex 1- Application to List Securities Issued For a Public Offer, and
- f. Annex 2- Brief (Short) Prospectus on Securities Issued for a Public Offer

If this recommendation is accepted, the IPO regulation will reflect the principles-based format viewed by IOSCO as providing the most flexibility and adaptability as well as significant IOSCO, SEC and EU standards.

**Short Prospectus for potential investors.** The regulation should require that every prospective investor receive a shortened version of the prospectus before filling out an application form to purchase securities. This Short prospectus should contain information set forth in the “Brief Prospectus” Annex 2 of the IPO Regulation and be in a format that is “reader friendly” and thus more useful to an average investor.

Internationally, the shortened prospectus includes a summary of much of the information in the full prospectus. It is generally recognized that individuals will not read material that is written in highly technical language or that is hard to read because of the size of type and the format. It is for this reason the US SEC has rules governing type size and requiring disclosure documents to be in plain English, to avoid legal jargon or highly technical business terms and to present information in tabular form or bullet lists, whenever possible.

This document should be reviewed by FRC staff to assure that in summarizing information, material disclosure is not omitted.

**Requirement of Management Discussion and Analysis in Financial Reports.** The inclusion of Management Discussion and Analysis (MD&A) in financial reports has become an international standard. MD&A provides information about the components of a company’s earnings and cash flow and helps make sense of complex financial statements and risk factors. Such disclosure of management’s assessment of factors and trends which are anticipated to have a material effect on the company’s future financial condition and operations enables investors to look at the company through the eyes of management.

MD&A should include among other things, a summary of financial results for the past three years, an analysis of the reasons for changes in income and expenses, a discussion of unusual or infrequent events or transactions; economic changes that materially affected operations; known trends or uncertainties that have or may effect revenue and income; total turnover of each major industry segment; competitive conditions; seasonal nature of the business.

The revised FRC IPO regulations should require MD&A in financial reports.

**Prospectus dissemination.** There currently exists a significant difference in the amount of disclosure available to the public and that available to underwriters and investment advisers in the IPO process. The FRC should alleviate this problem by requiring a much greater level of disclosure of information to the public by an issuer during the IPO application and prospectus preparation period and during public offerings.

At a minimum the draft prospectus and the final prospectus should be placed on the FRC's web site and kept there until the offering is completed. In addition, prospectuses should be available from FRC, the MSE, the underwriter, and the company.

A prospectus should be used for road shows and also in connection with book building. The FRC should publish a circular prohibiting the furnishing of any information in a road show that is not in the prospectus, which should help to assure that some purchasers of securities in a public offering do not have information that is not available to all purchasers.

**Due diligence.** An underwriter is commonly understood to be a person who buys securities directly or indirectly from the issuer and resells them to the public, or performs some act or acts that facilitates the issuer's distribution of the issuer's securities. In Mongolia, underwriting activities are similarly defined in the Securities Law.<sup>32</sup>

In most mature markets underwriters occupy a unique position that enables them to discover and compel disclosure of essential facts about the offering. This is done by exercising a reasonable investigation during the underwriting process to assure the underwriter that information included in the application and prospectus is accurate.

The conduct and practice of proper due diligence by underwriters needs to be improved. The underwriter must investigate enough to be assured that it has a firm grasp on the business and affairs of an issuer so that it can offer and sell securities with confidence that its customers have been fully apprised of the legal, financial and business position of the issuer.

At this time, under the Securities Law, a licensed underwriting company is responsible for monitoring the accuracy of facts and information reflected or attached in the introduction of issuing and publicly offering the securities and for any losses caused by incorrect and not revealed by the issuer.<sup>33</sup> However, when an application and prospectus are filed with FRC, the issuer (or underwriter and investment advisors) is not required to perform extensive investigation or due diligence or to provide a due diligence certificate, as is the practice in many jurisdictions. Furthermore, there is no corresponding section in the Securities Law clearly setting forth sanctions in the event disclosure violations occur in connection with the application and prospectus.

The FRC should require the submission of a due diligence certificate by persons involved in the preparation of an IPO to confirm that, based on their examination of the relevant documents and discussions with company officers, directors and experts, including auditors, the prospectus complies with all legal requirements relating to the offering and that the disclosures are true, fair and adequate to enable the investors to make a well informed decision as to the investment merits of the issue.

The Securities Law should be amended to clearly setting forth sanctions in the event disclosure violations occur in connection with the application and prospectus filing for an IPO.

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<sup>32</sup> Securities Law, Section 3.1.12

<sup>33</sup> Securities Law, Section 28.2

**FRC staff review of filings.** When an IPO filing is made with the FRC an Application and Prospectus are furnished. The application and prospectus are distributed to two professionals in the Securities Markets Department. It is recommended that notice of the filing is also sent to other relevant departments in FRC, including the Investigation and Enforcement Department, to determine whether they have any information about the company.

**Procedural changes.** The FRC should consider extensive use of instructions, circulars, releases and other measures to improve IPO processing at the FRC. The use of a regulatory check list will not be sufficient to increase the efficiency of the IPO review process. Interviews in the financial community indicated that more written guidance, clarification, and streamlining of procedures are required from the FRC.

**Integration of private offerings.** In Mongolia, a public offering of securities means an offer of securities of an issuer to more than 50 persons through a securities trading institution in accordance with the regulations of the Commission.<sup>34</sup> The Securities Law requires that an issue of securities closed to the public shall be registered at the Commission if the previous issue of those securities were offered to the public.<sup>35</sup> Otherwise, the offering would not be a public offering and such offerings are not subject to the detailed disclosure requirements applicable to public offerings. In fact, there are no specified disclosure requirements for such offerings.

The concept of integration should be applied to offerings closed to the public, so that companies cannot indirectly make public offerings without complying with the disclosure requirements of FRC. At this time, there is no prohibition against making a series of private offerings, even though only a short time has elapsed between offerings. It could develop that issuers will follow this practice to avoid the application and prospectus requirements of the Mongolian Securities Law.

The U.S. Securities and Exchange Commission has long taken the position that a series of private offerings may, in fact, be one offering and should be viewed as such. The factors to be considered in determining whether two or more offerings should be integrated are: whether the sales are part of a single plan of financing; (ii) whether the sales involve issuance of the same class of securities; (iii) whether sales have been made at or about the same time; (iv) whether the same type of consideration is received; or (v) whether the sales are made for the same general purposes.

FRC should consider taking a similar approach to avoid abuses that may exist or may develop regarding offering to fewer than 50 bodies in Mongolia. This issue will likely become even more significant as the IPO process becomes more closely regulated by the FRC.

**FRC staff training.** At this time, FRC has no formal training program for the professionals who are responsible for reviewing the disclosure documents. They are expected to learn on the job. It is also the policy of FRC to rotate its staff members every three years with the result that there are no employees with long term experience in any one role. The number of filings varies substantially from year to year which can result in either so few filings that gaining experience is difficult or so many filings that the more experienced staff have little time to train new employees.

The FRC and MSE should establish a regular training schedule, with at least one training program focused on disclosure issues every year. In addition to using their senior staff as presenters of these programs, it is possible that members of the Primary Market Committee and the Secondary Market Committee could also contribute as speakers.

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<sup>34</sup> Securities Law, Section 3.1.13

<sup>35</sup> Securities Law, Section 7.2

In addition, consideration should be given to developing a training manual that could be used not only to assist in training new employees, but could also act as a reference source for more experienced employees.

**ANNEX A: DISCLOSURE REQUIREMENTS IN THE IPO REGULATION**

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## **ANNEX A: DISCLOSURE REQUIREMENTS IN THE IPO REGULATION**

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The IPO Regulation sections governing IPO applications and prospectuses and related components included in Chapters 1-3 and 7, and Annexes 1 and 2 should be expanded to strengthen the disclosure requirements and incorporate the principles-based format viewed by IOSCO as providing the most flexibility and adaptability and to reflect significant IOSCO, SEC and EU standards.

We recommend the following wording be incorporated into the regulation:

### **I. Identity of directors, senior management and advisers**

The purpose of this regulation requirement is to identify the company representatives and other individuals involved in the company's listing or registration as well as identify the persons responsible for the document.

#### **FRC regulation requirement:**

1. Provide the names, business addresses and functions of the directors and senior management
2. Provide the names and addresses of the principal bankers and legal advisers to the extent that the issuer has a continuing relationship with such entities, the sponsor for listing, and the legal advisers to the issue.
3. Provide the names and addresses of the issuer's auditors for the preceding three years, together with their membership in a professional body.

### **II. IPO statistics and expected timetable**

Provide key information regarding the conduct of any offering and the identification of important dates relating to that offering.

#### **FRC regulation requirement:**

1. For the offering state the total expected amount of the issue, including the expected issue price or the method of determining the price and the number of securities expected to be issued.
2. For the offerings and separately for each group of targeted potential investors, the document shall state the following information to the extent applicable to the offering procedure:
  - a) The time period during which the offer will be open, and where and to whom purchase or subscription applications shall be addressed. Describe whether the purchase period may be extended or shortened, and the manner and duration of possible extensions or possible early closure or shortening of this period. Describe the manner in which the latter shall be made public. If the exact dates are not known when the document is first filed or distributed to the public, describe arrangements for announcing the final or definitive date or period.
  - b) Method and time limits for paying up securities and, where payment is partial, the manner and dates on which amounts due are to be paid.
  - c) Method and time limits for delivery of equity securities (including provisional certificates, if applicable) to subscribers or purchasers.
  - d) In the case of pre-emptive purchase rights, the procedure for the exercise of any right of pre-emption, the negotiability of subscription rights and the treatment of subscription rights not exercised. And,

- e) A full description of the manner in which results of the distribution of securities are to be made public.

### III. Risk factors

The Risk Factors section is intended to be a summary of more detailed discussion contained elsewhere in the document.

#### **FRC regulation requirement:**

Describe any risk factors material to the issuer that a reasonable investor would consider relevant to an investment in the securities being distributed. Describe risk factors that are specific to the company and also to its industry and that make an offering speculative or one of high risk, in a section headed: List the risk factors in the order of their priority to the company. Among other things, such factors include:

- a. the nature of the business in which it is engaged or proposes to engage;
- b. factors relating to the countries in which it operates;
- c. the absence of profitable operations in recent periods; the financial position of the company;
- d. the possible absence of a liquid trading market for the company's securities;
- e. reliance on the expertise of management;
- f. potential dilution;
- g. unusual competitive conditions;
- h. pending expiration of material patents, trademarks or contracts;
- i. dependence on a limited number of customers or suppliers;
- j. cash flow and liquidity problems;
- k. experience of management;
- l. general risks inherent in the business carried on by the issuer;
- m. environmental and health risks;
- n. reliance on key personnel
- o. regulatory constraints, and economic or political conditions;
- p. financial history; and
- q. any other matter that would be likely to influence the decision of an investor to purchase securities of the issuer. If there is a risk that security holders of the issuer may become liable to make an additional contribution beyond the price of the security, disclose that risk.

In addition, the following instruction should be added:

#### *Instruction*

- (1) *Disclose risks in the order of seriousness from the most serious to the least serious, and*
- (2) *A risk factor must not be de-emphasized by including excessive caveats or conditions.*

In the Instruction, examples of risk factors should also be added, such as:

*“An investment in our company involves significant risks. You should read these risk factors carefully before deciding whether to invest in our company. The following is a description of what we consider our key challenges and risks related to the business and industry of the issuer.*

*Changes in revenues and income may result from a variety of social, legal and economic factors, including, without limitation, the rate of inflation and unemployment levels. There can be no assurances that income will continue at the present rate due to a deterioration in the financial strength or managerial capabilities of the company, natural disasters, taxes and*

government regulations which influence or determine employee wages, product prices, interest rates, manufacturing procedures and costs; and changes in customer preferences, or other factors.

*We expect that in the future our revenue growth rate will decline and anticipate that there will be downward pressure on our operating margin. We believe our revenue growth rate will decline as a result of anticipated changes to our advertising program revenue mix, increasing competition and the inevitable decline in growth rates as our net revenues increase to higher levels. We believe our operating margin will decline as a result of increasing competition and increased expenditures for all aspects of our business as a percentage of our net revenues, including product development and sales and marketing expenses. We also expect that our operating margin may decline as a result of increases in the proportion of our net revenues generated from our particular members. The margin on revenue we generate from our particular members is generally significantly less than the margin on revenue we generate from advertising in other areas.*

*Our operating results may fluctuate as a result of a number of factors, many of which are outside of our control. The following factors may affect our operating results:*

- *Our ability to compete effectively.*
- *Our ability to continue to attract particular customers.*
- *Our ability to attract advertisers.*
- *The amount and timing of operating costs and capital expenditures related to the maintenance and expansion of our businesses, operations and infrastructure.*
- *Our focus on long term goals over short-term results.*
- *The results of our investments in risky projects.*
- *General economic conditions and those economic conditions specific to our business.*
- *The success of our geographical and product expansion.*
- *Our ability to attract, motivate and retain top-quality employees.*
- *Our ability to upgrade and develop our systems, infrastructure and products.*
- *The costs and results of litigation that we face.*
- *Our ability to successfully integrate and manage our acquisitions.”*

#### **IV. Financial information**

##### **FRC regulation requirement**

1. The company shall provide selected historical financial data regarding the company, which shall be presented for the five most recent financial years (or such shorter period that the company has been in operation), in the same currency as the financial statements. Selected financial data for either or both of the earliest two years of the five-year period may be omitted. If interim period financial statements are included, the selected financial data should be updated for that interim period, which may be unaudited, provided that fact is stated. If selected financial data for interim periods is provided, comparative data from the same period in the prior financial year shall also be provided, except that the requirement for comparative balance sheet data is satisfied by presenting the year end balance sheet information.
2. The selected financial data presented shall include items generally corresponding to the following, except that the specific line items presented should be expressed in the same manner as the corresponding line items in the company's financial statements. Such data shall include, at a minimum, net sales or operating revenues; income (loss) from operations; income (loss) from continuing operations; net income (loss); net income

(loss) from operations per share; income (loss) from continuing operations per share; total assets; net assets; capital stock (excluding long term debt and redeemable preferred stock); number of shares as adjusted to reflect changes in capital; dividends declared per share in both the currency of the financial statements and the host country currency, including the formula used for any adjustments to dividends declared; and diluted net income per share. Per share amounts must be determined in accordance with the body of accounting principles used in preparing the financial statements.

3. A statement of capitalization and indebtedness (distinguishing whether indebtedness is guaranteed, secured and unsecured) as of a date no earlier than 60 days prior to the date of the document shall be provided showing the company's capitalization on an actual basis and, if applicable, as adjusted to reflect the sale of new securities being issued and the intended application of the net proceeds. Indebtedness also includes indirect and contingent indebtedness.

## **V. Reasons for the offer and use of proceeds.**

### **FRC regulation requirement**

1. The issuer shall disclose the estimated net amount of the proceeds broken down into each principal intended use. If the anticipated proceeds will not be sufficient to fund all the proposed purposes, the order of priority of such purpose should be given, as well as the amount and sources of other funds needed. If the company has no specific plans for the proceeds, it should discuss the principal reasons for the offering.
2. If the proceeds are being used directly or indirectly to acquire assets, other than in the ordinary course of business, briefly describe the assets and their cost. If the assets will be acquired from affiliates of the company or their associates, disclose the persons from whom they will be acquired and how the cost to the company will be determined.
3. If the proceeds may or will be used to finance acquisitions of other businesses, give a brief description of such businesses and information on the status of the acquisitions.
4. If any material part of the proceeds is to be used to discharge, reduce or retire indebtedness, describe the interest rate and maturity of such indebtedness and, for indebtedness incurred within the past year, the uses to which the proceeds of such indebtedness were put.

## **VI. Information on the company**

### **FRC regulation requirement:**

Describe the business operations of the issuer, the products it makes or the services it provides, and the factors which affect the business. Provide information regarding the adequacy and suitability of the company's properties, plants and equipment, as well as its plans for future increases or decreases in such capacity and provide current valuations of its properties. The following information about the history and development of the issuer shall be provided:

1. The legal and commercial name of the issuer.
2. The date of incorporation and the length of life of the issuer, except where indefinite.
3. The legal form of the issuer, the legislation under which the issuer operates and the address and telephone number of its registered office or principal place of business if different from its registered office. Provide the name and address of the agent of the issuer, if any.
4. The important events in the development of the business, including information concerning the nature and results of any material reclassification, merger or

- consolidation of the issuer or any of its significant subsidiaries; acquisitions or dispositions of material assets other than in the ordinary course of business; any material changes in the mode of conducting the business; material changes in the types of products produced or services rendered; name changes; or the nature and results of any bankruptcy, receivership or similar proceedings with respect to the issuer or significant subsidiaries.
5. A description, including the amount invested, of the principal capital expenditures and divestitures (including interests in other issuers), since the beginning of the company's last three financial years to the date of the offering or listing document.
  6. Information concerning the principal capital expenditures and divestitures currently in progress, including the distribution of these investments geographically (Mongolia and abroad) and the method of financing (internal or external).
  7. An indication of any public takeover offers by third parties in respect of the company's shares or by the company in respect of other companies' shares which have occurred during the last and current financial year. The price or exchange terms attaching to such offers and the outcome thereof are to be stated.

## **VII. Business overview.**

### **FRC regulation requirement:**

The information required may be presented on the same basis as that used to determine the company's business segments under the body of accounting principles used in preparing the financial statements. The following information shall be provided:

1. A description of the nature of the company's operations and its principal activities, stating the main categories of products sold and/or services performed for each of the last three financial years. Indicate any significant new products and/or services that have been introduced and, to the extent the development of new products or services has been publicly disclosed, give the status of development.
2. A description of the principal markets in which the issuer competes, including a breakdown of total revenues by category of activity and geographic market for each of the last three financial years.
3. A description of the seasonality of the main business of the issuer.
4. A description of the sources and availability of raw materials, including a description of whether prices of principal raw materials are volatile.
5. A description of the marketing channels used by the issuer, including an explanation of any special sales methods, such as installment sales.
6. Summary information regarding the extent to which the issuer is dependent, if at all, on patents or licenses, industrial, commercial or financial contracts (including contracts with customers or suppliers) or new manufacturing processes, where such factors are material to the business or profitability.
7. The basis for any statements made by the issuer regarding its competitive position shall be disclosed.
8. A description of the material effects of government regulations on the business, identifying the regulatory body.
9. If the issuer is part of a group, include a brief description of the group and its position within the group. Provide a listing of significant subsidiaries, including name, country of incorporation or residence if not Mongolia, proportion of ownership interest and, if different, proportion of voting power held.

## **VIII. Property, plants and equipment.**

### **FRC regulation requirement:**

The issuer shall provide information regarding any material tangible fixed assets, including leased properties, and any major encumbrances thereon, including a description of the size and uses of the property; productive capacity and extent of utilization of the facilities of the issuer; how the assets are held; the products produced; and the location. Also describe any environmental issues that may affect utilization of assets by the company. With regard to any material plans to construct, expand or improve facilities, describe the nature of and reason for the plan, an estimate of the amount of expenditures including the amount of expenditures already paid, a description of the method of financing the activity, the estimated dates of start and completion of the activity, and the increase of production capacity anticipated after completion.

## **IX. Operating and financial review and prospects**

### **FRC regulation requirement:**

1. Generally provide an explanation by management of factors that have affected the financial condition of the issuer and results of operations for the historical periods covered by the financial statements, and management's assessment of factors and trends which are anticipated to have a material effect on the financial condition and results of operations of the issuer in future periods.
2. In greater detail, discuss the company's financial condition, changes in financial condition and results of operations for each year and interim period for which financial statements are required, including the causes of material changes from year to year in financial statement line items, to the extent necessary for an understanding of the company's business as a whole. Information provided also shall relate to all separate segments of the issuer. Provide the information specified below as well as such other information that is necessary for an investor to understand the financial condition, changes in financial condition and results of operation of the issuer.
3. Provide information regarding significant factors, including unusual or infrequent events or new developments, materially affecting income from operations of the issuer, indicating the extent to which income was so affected. Describe any other significant component of revenue or expenses necessary to understand the results of operations.
  - a) To the extent that the financial statements disclose material changes in net sales or revenues, provide a narrative discussion of the extent to which such changes are attributable to changes in prices or to changes in the volume or amount of products or services being sold or to the introduction of new products or services
  - b) Describe the impact of inflation, if material. Regarding hyperinflation, the existence of such inflation, a five year history of the annual rate of inflation and a discussion of the impact of hyperinflation on the business shall be disclosed.
  - c) Provide information regarding the impact of foreign currency fluctuations on the issuer, if material, and the extent to which foreign currency net investments are hedged by currency borrowings and other hedging instruments.
  - d) Provide information regarding any Mongolian governmental economic, fiscal, monetary or political policies or factors that have materially affected, or could materially affect, directly or indirectly, operations or investments.
4. The following information shall be provided:

- a) Information regarding both short and long term liquidity of the issuer, including (i) a description of the internal and external sources of liquidity and a brief discussion of any material unused sources of liquidity. Include a statement by the issuer that, in its opinion, the working capital is sufficient for present requirements, or, if not, how it proposes to provide the additional working capital needed; (ii) an evaluation of the sources and amounts of the company's cash flows, including the nature and extent of any legal or economic restrictions on the ability of subsidiaries to transfer funds to the company in the form of cash dividends, loans or advances and the impact such restrictions have had or are expected to have on the ability of the issuer to meet its cash obligations; (iii) information on the level of borrowings at the end of the period under review, the seasonality of borrowing requirements and the maturity profile of borrowings and committed borrowing facilities, with a description of any restrictions on their use.
- b) Information regarding the type of financial instruments used the maturity profile of debt, currency and interest rate structure. The discussion also should include funding and treasury policies and objectives in terms of the manner in which treasury activities are controlled, the currencies in which cash and cash equivalents are held, the extent to which borrowings are at fixed rates, and the use of financial instruments for hedging purposes.
- c) Information regarding material commitments of the issuer for capital expenditures as of the end of the latest financial year and any subsequent interim period and an indication of the general purpose of such commitments and the anticipated sources of funds needed to fulfill such commitments.

## **X. Research and development, patents and licenses**

### **FRC regulation requirement:**

Provide a description of research and development policies for the issuer for the last three years, where it is significant, including the amount spent during each of the last three financial years on issuer-sponsored research and development activities.

## **XI. Trend information.**

### **FRC regulation requirement:**

Identify the most significant recent trends in production, sales and inventory, the state of the order book and costs and selling prices since the latest financial year. The issuer also should discuss, for at least the current financial year, any known trends, uncertainties, demands, commitments or events that are reasonably likely to have a material effect on net sales or revenues, income from continuing operations, profitability, liquidity or capital resources, or that would cause reported financial information not necessarily to be indicative of future operating results or financial condition.

## **VII. Director, senior management, and employee information**

### **FRC regulation requirement:**

Provide information concerning directors and managers of the issuer that will allow investors to assess such their experience, qualifications and levels of compensation, as well as their relationship with the issuer. Information concerning the employees of the issuer.

1. Directors and Senior Management. The following information shall be disclosed with respect to directors and senior management, and any employees such as scientists or designers upon whose work the issuer is dependent:
  - a) Name, business experience, functions and areas of experience in the issuer.
  - b) Principal business activities performed outside the issuer.
  - c) The nature of any family relationship between any of the persons named above.
  - d) Any arrangement or understanding with major shareholders, customers, suppliers or others, pursuant to which any person referred to above was selected as a director or member of senior management.
2. Compensation. Provide the following information for the last full financial year for the directors and members of its administrative, supervisory or management:
  - a) The amount of compensation paid, and benefits in kind granted, to such persons by the issuer and its subsidiaries for services in all capacities to the company and its subsidiaries by any person. Disclosure of compensation is required on an individual basis. Contingent or deferred compensation accrued for the year, even if the compensation is payable at a later date. If any portion of the compensation was paid (a) pursuant to a bonus or profit-sharing plan, provide a brief description of the plan and the basis upon which such persons participate in the plan; or (b) in the form of stock options, provide the title and amount of securities covered by the options, the exercise price, the purchase price (if any), and the expiration date of the options.
  - b) The total amounts set aside or accrued by the issuer or its subsidiaries to provide pension, retirement or similar benefits.
3. Board Practices. The following information for the last completed financial year shall be given with respect to, unless otherwise specified, the directors, and members of its administrative, supervisory or management of the issuer.
  - a) Date of expiration of the current term of office, if applicable, and the period during which the person has served in that office.
  - b) Details of directors' service contracts with the issuer or any of its subsidiaries providing for benefits upon termination of employment, or an appropriate negative statement.
  - c) Details relating to the audit committee and remuneration committee of the issuer, including the names of committee members and a summary of the terms of reference under which the committee operates.
4. Employees. Provide either the number of employees at the end of the period or the average for the period for each of the past three financial years (and changes in such numbers, if material) and, if possible, a breakdown of persons employed by main category of activity and geographic location. Also disclose any significant change in the number of employees, and information regarding the relationship between management and labor unions. If the issuer employs a significant number of temporary employees, include disclosure of the number of temporary employees on an average during the most recent financial year.
5. With respect to the Directors and Senior Management, provide information as to their share ownership in the issuer as of the most recent practicable date (including disclosure on an individual basis of the number of shares and percent of shares outstanding of that class, and whether they have different voting rights) held and options granted to them on shares of the issuer. Information regarding options shall

include: the title and amount of securities called for by the options; the exercise price; the purchase price, if any; and the expiration date of the options.

6. Describe any arrangements for involving the employees in the capital of the issuer, including any arrangement that involves the issue or grant of options or shares or securities of the issuer.

### **VIII. Major shareholders and related party transactions**

*Instruction:*

*Provide information regarding the major shareholders and others that control or may control the issuer. Also provide information regarding transactions the issuer has entered into with persons affiliated with the issuer and whether the terms of such transactions are fair to the issuer. Disclose related party transactions not required to be disclosed under the body of accounting principles used in preparing the financial statements.*

**FRC regulation requirement:**

1. Major Shareholders- To the extent that the following information is known to the issuer or can be ascertained from public filings, it should be provided as of the most recent practicable date, with references to the number of shares held in the issuer including shares beneficially owned:
  - a) Information shall be provided regarding the major shareholders of the issuer, which means shareholders that are the beneficial owners of 5% or more of each class of voting securities:
    - i. Provide the names of the major shareholders, and the number of shares and the percentage of outstanding shares of each class owned by each of them as of the most recent practicable date, or an appropriate negative statement if there are no major shareholders.
    - ii. Disclose any significant change in the percentage ownership held by any major shareholders during the past three years.
    - iii. Indicate whether the major shareholders have different voting rights, or an appropriate negative statement.
  - b) Information shall be provided as to the portion of each class of securities held and the number of record holders.
  - c) To the extent known to the issuer, state whether the issuer is directly or indirectly owned or controlled by another issuer(s), by any foreign government or by any other natural or legal person(s) severally or jointly, and, if so, give the name(s) of such controlling issuer(s), government or other person(s), and briefly describe the nature of such control, including the amount and proportion of capital held giving a right to vote.
  - d) Describe any arrangements, known to the issuer, the operation of which may at a subsequent date result in a change in control of the company.
2. Related Party Transactions. Provide the information required below for the period since the beginning of the issuer's preceding three financial years up to the date of the document, with respect to transactions or loans between the issuer and (a) enterprises that directly or indirectly through one or more intermediaries, control or are controlled by, or are under common control with, the issuer; (b) associates; (c) individuals owning, directly or indirectly, an interest in the voting power of the issuer that gives them significant influence over the issuer, and close members of any such individual's family; (d) key management personnel, that is, those persons having authority and

responsibility for planning, directing and controlling the activities of the issuer, including directors and senior management of issuers and close members of such individuals' families; and (e) enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (c) or (d) or over which such a person is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the issuer and enterprises that have a member of key management in common with the issuer. Close members of an individual's family are those that may be expected to influence, or be influenced by, that person in their dealings with the issuer. An associate is an unconsolidated enterprise in which the issuer has a significant influence or which has significant influence over the issuer. *Explanation:* Significant influence over an enterprise is the power to participate in the financial and operating policy decisions of the enterprise but is less than control over those policies. Shareholders beneficially owning a 10 percent interest in the voting power of the issuer are presumed to have a significant influence on the issuer.

- a) The nature and extent of any transactions or presently proposed transactions which are material to the issuer or the related party, or any transactions that are unusual in their nature or conditions, involving goods, services, or tangible or intangible assets, to which the issuer or any of its parent or subsidiaries was a party.
  - b) The amount of outstanding loans (including guarantees of any kind) made by the issuer or any of its parent or subsidiaries to or for the benefit of any of the persons listed above. The information given should include the largest amount outstanding during the period covered, the amount outstanding as of the latest practicable date, the nature of the loan and the transaction in which it was incurred, and the interest rate on the loan.
3. Interests of Experts and Counsel. If any of the named experts or counselors was employed on a contingent basis, owns an amount of shares in the issuers or its subsidiaries which is material to that person, or has a material, direct or indirect economic interest in the issuer or that depends on the success of the offering, provide a brief description of the nature and terms of such contingency or interest.

## **IX. Financial information**

Provide the information as set forth in the Regulation for the years required in another part of this Regulation.

### **FRC regulation requirement:**

#### **1. Consolidated statements and other financial information.**

- a) The application must contain consolidated financial statements, audited by an independent auditor and accompanied by an audit report, comprised of:
  - i. balance sheet;
  - ii. income statement;
  - iii. statement showing either (i) changes in equity other than those arising from capital transactions with owners and distributions to owners; or (ii) all changes in equity (including a subtotal of all non-owner items recognized directly in equity);
  - iv. cash flow statement;

- v. related notes and schedules required by the comprehensive body of accounting standards pursuant to which the financial statements are prepared; and
  - vi. if not included in the primary financial statements, a note analyzing the changes in each caption of shareholders' equity presented in the balance sheet.
- b) The application should include comparative financial statements that cover the latest three financial years, audited in accordance with Mongolia's auditing standards.
  - c) The audit report(s) must cover each of the periods for which IAS disclosure standards require audited financial statements. If the auditors have refused to provide a report on the annual accounts or if the report(s) contain qualifications or disclaimers, such refusal or such qualifications or disclaimers shall be reproduced in full and the reasons given, so the FRC can determine whether or not to accept the financial statements. Include an indication of any other information in the document which has been audited by the auditors.
  - d) The last year of audited financial statements may not be older than 15 months at the time of the offering or listing; provided, however, that in the case of the issuer's initial public offering, unless the FRC permits otherwise, the audited financial statements also shall be as of a date not older than 12 months at the time the document is filed. In such cases, the audited financial statements may cover a period of less than a full year.
  - e) If the application is dated more than nine months after the end of the last audited financial year, it should contain consolidated interim financial statements, which may be unaudited (in which case that fact should be stated), covering at least the first six months of the financial year. The interim financial statements should include a balance sheet, income statement, cash flow statement, and a statement showing either (i) changes in equity other than those arising from capital transactions with owners and distributions to owners, or (ii) all changes in equity (including a subtotal of all non-owner items recognized directly in equity). Each of these statements may be in condensed form as long as it contains the major line items from the latest audited financial statements and includes the major components of assets, liabilities and equity (in the case of the balance sheet); income and expenses (in the case of the income statement) and the major subtotals of cash flows (in the case of the cash flow statement).

The interim financial statements should include comparative statements for the same period in the prior financial year, except that the requirement for comparative balance sheet information may be satisfied by presenting the year end balance sheet. If not included in the primary financial statements, a note should be provided analyzing the changes in each caption of shareholders' equity presented in the balance sheet. The interim financial statements should include selected note disclosures that will provide an explanation of events and changes that are significant to an understanding of the changes in financial position and performance of the issuer since the last annual reporting date. If, at the date of the document, the issuer has published interim financial statements that cover a more current period than those otherwise required by this standard, the more current interim financial statements must be included in the document.

*Instruction:*

*Issuers are encouraged, but not required, to have any interim financial statements in the document reviewed by an independent auditor. If such a review has been performed and is referred to in the document, a copy of the auditor's interim review report must be provided in the document.*

- f) If the amount of export sales constitutes a significant portion of the issuer's total sales volume, provide the total amount of export sales and the percent and amount of export sales in the total amount of sales volume.
- g) Provide information on any legal or arbitration proceedings, including those relating to bankruptcy, receivership or similar proceedings and those involving any third party, which may have, or have had in the recent past, significant effects on the issuer's financial position or profitability. This includes governmental proceedings pending or known to be contemplated.
- h) Describe the dividend distributions policy of the issuer.

**2. Significant changes.**

Disclose whether or not any significant change has occurred since the date of the annual financial statements, and/or since the date of the most recent interim financial statements, if any, included in the document.

**X. The offer and listing**

*Instruction:*

*Provide information regarding the offer or listing of securities, the plan for distribution of the securities and related matters.*

**FRC regulation requirement:**

**1. Offer and listing details.**

- a) Indicate the expected price at which the securities will be offered or the method of determining the price, and the amount of any expenses specifically charged to the subscriber or purchaser.
- b) If there is not an established market for the securities (unlikely in an IPO), the document shall contain information regarding the manner of determination of the offering price as well as of the exercise price of warrants and the conversion price of convertible securities, including who established the price or who is formally responsible for the determination of the price, the various factors considered in such determination and the parameters or elements used as a basis for establishing the price.
- c) If the issuer's shareholders have pre-emptive purchase rights and where the exercise of the right of pre-emption of shareholders is restricted or withdrawn, the issuer shall indicate the basis for the issue price if the issue is for cash, together with the reasons for such restriction or withdrawal and the beneficiaries of such restriction or withdrawal if intended to benefit specific persons.
- d) Information regarding the price history of the stock to be offered or listed shall be disclosed as follows:
  - i. for the five most recent full financial years: the annual high and low market prices;

- ii. for the two most recent full financial years and any subsequent period: the high and low market prices for each full financial quarter;
- iii. for the most recent six months: the high and low market prices for each month;
- iv. for pre-emptive issues, the market prices for the first trading day in the most recent six months, for the last trading day before the announcement of the offering and (if different) for the latest practicable date prior to publication of the document.

*Instruction:*

*Information shall be given with respect to the market price at the MSE and the principal trading market outside of Mongolia. If significant trading suspensions occurred in the prior three years, they shall be disclosed. If the securities are not regularly traded in an organized market, information shall be given about any lack of liquidity.*

- e) State the type and class of the securities being offered or listed and furnish the following information:
  - i. Indicate the type of shares and provide the number of shares to be issued and to be made available to the market for each kind of share and a statement of the minimum offer price;
  - ii. Describe arrangements for transfer and any restrictions on the free transferability of the shares.
- f) If the rights evidenced by the securities being offered and listed are or may be materially limited or qualified by the rights evidenced by any other class of securities or by the provisions of any contract or other documents, include information regarding such limitation or qualification and its effect on the rights evidenced by the securities to be listed or offered.
- g) With respect to securities other than common shares to be listed or offered, outline briefly the rights evidenced thereby.
  - i. If subscription warrants or rights are to be listed or offered, state: the title and amount of securities called for; the amount of warrants or rights outstanding; provisions for changes to or adjustments in the exercise price; the period during which and the price at which the warrants or rights are exercisable; and any other material terms of such warrants or rights.
  - ii. Where convertible securities or stock purchase warrants to be listed or offered are subject to redemption or call, the description of the conversion terms of the securities or material terms of the warrants shall include whether the right to convert or purchase the securities will be forfeited unless it is exercised before the date specified in the notice of redemption or call; the expiration or termination date of the warrants; the kind, frequency and timing of notice of the redemption or call, including where the notice will be published; and, in the case of bearer securities, that investors are responsible for making arrangements to prevent loss of the right to convert or purchase in the event of redemption or call.

## **2. Plan of distribution.**

- a. The names and addresses of the entities underwriting or guaranteeing the offering shall be listed.

- b. To the extent known to the issuer, indicate whether major shareholders, directors or members of management, supervisory or administrative bodies intend to subscribe in the offering, or whether any person intends to subscribe for more than 5 percent of the offering.
  - c. Identify any group of targeted potential investors to whom the securities are offered.
  - d. If securities are reserved for allocation to any group of targeted investors, including, for example, offerings to existing shareholders, directors, or employees and past employees of the issuer or its subsidiaries, provide details of these and any other preferential allocation arrangements.
  - e. Indicate whether the amount of the offering could be increased, such as by the exercise of an underwriter's over-allotment option and by how much.
  - f. Indicate the amount, and outline briefly the plan of distribution, of any securities that are to be offered otherwise than through underwriters. If the securities are to be offered through the selling efforts of brokers or dealers, describe the plan of distribution and the terms of any agreement or understanding with such entities. If known, identify the broker(s) or dealer(s) that will participate in the offering and state the amount to be offered through each.
  - g. If the securities are to be offered in connection with the writing of exchange-traded call options, describe briefly such transactions.
  - h. If simultaneously or almost simultaneously with the creation of shares for which admission to official listing is being sought, shares of the same class are subscribed for or placed privately or if shares of other classes are created for public or private placing, details are to be given of the nature of such operations and of the number and characteristics of the shares to which they relate.
  - i. Describe the features of the underwriting relationship together with the amount of securities being underwritten by each underwriter in privity of contract with the issuer or selling shareholders. The foregoing information should include a statement as to whether the underwriters are or will be committed to take and to pay for all of the securities if any are taken, or whether it is an agency or the type of "best efforts" arrangement under which the underwriters are required to take and to pay for only such securities as they may sell to the public.
  - j. If any underwriter or other financial adviser has a material relationship with the issuer, describe the nature and terms of such relationship.
- 3. Markets.** The issuer shall disclose all stock exchanges and other regulated markets on which the securities to be offered or listed are traded. When an application for admission to any exchange and/or regulated market is being or will be sought, this must be mentioned, without creating the impression that the listing necessarily will be approved. If known, the dates on which the shares will be listed and dealt in should be given.
- 4. Selling shareholders.** The following information shall be provided:
- a) The name and address of the person or entity offering to sell the shares, the nature of any position, office or other material relationship that the selling shareholder has had within the past three years with the issuer or any of its predecessors or affiliates.
  - b) The number and class of securities being offered by each of the selling shareholders, and the percentage of the existing equity capital. The amount and

percentage of the securities for each particular type of securities beneficially held by the selling shareholder before and immediately after the offering shall be specified.

**5. Dilution.** The following information shall be provided:

- a. Where there is a substantial disparity between the public offering price and the effective cash cost to directors or senior management, or affiliated persons, of equity securities acquired by them in transactions during the past five years, or which they have the right to acquire, include a comparison of the public contribution in the proposed public offering and the effective cash contributions of such persons.
- b. Disclose the amount and percentage of immediate dilution resulting from the offering, computed as the difference between the offering price per share and the net book value per share for the equivalent class of security, as of the latest balance sheet date.
- c. In the case of a subscription offering to existing shareholders, disclose the amount and percentage of immediate dilution if they do not subscribe to the new offering.

**6. Expenses of the issue.** The following information shall be provided:

- a) The total amount of the discounts or commissions agreed upon by the underwriters or other placement or selling agents and the issuer shall be disclosed, as well as the percentage such commissions represent of the total amount of the offering and the amount of discounts or commissions per share.
- b) A reasonably itemized statement of the major categories of expenses incurred in connection with the issuance and distribution of the securities to be listed or offered and by whom the expenses are payable, if other than the issuer. If any of the securities are to be offered for the account of a selling shareholder, indicate the portion of such expenses to be borne by such shareholder. The information may be given subject to future contingencies. If the amounts of any items are not known, estimates (identified as such) shall be given.

## **XI. Additional information**

*Instruction:*

*Provide information, most of which is of a statutory nature that is not covered elsewhere in the Application.*

### **FRC regulation requirement**

**1. Share capital.** The following information shall be given as of the date of the most recent balance sheet included in the financial statements and as of the latest practicable date:

- a) The amount of issued capital and, for each class of share capital: (a) the number of shares authorized; (b) the number of shares issued and fully paid and issued but not fully paid; (c) the par value per share, or that the shares have no par value; and (d) a reconciliation of the number of shares outstanding at the beginning and end of the year. If more than 10 percent of capital has been paid for with assets other than cash within the past five years that fact should be stated.

- b) If there are shares not representing capital, the number and main characteristics of such shares shall be stated.
- c) Indicate the number, book value and face value of shares held by or on behalf of the issuer itself or by subsidiaries.
- d) Where there is authorized but unissued capital or an undertaking to increase the capital, for example, in connection with warrants, convertible obligations or other outstanding equity-linked securities, or subscription rights granted, indicate: (i) the amount of outstanding equity-linked securities and of such authorized capital or capital increase and, where appropriate, the duration of the authorization; (ii) the categories of persons having preferential subscription rights for such additional portions of capital; and (iii) the terms, arrangements and procedures for the share issue corresponding to such portions.
- e) The persons to whom any capital of any member of the group is under option or agreed conditionally or unconditionally to be put under option, including the title and amount of securities covered by the options; the exercise price; the purchase price, if any; and the expiration date of the options, or an appropriate negative statement. Where options have been granted or agreed to be granted to all the holders of shares or debt securities, or of any class thereof, or to employees under an employees' share scheme, it will be sufficient so far as the names are concerned, to record that fact without giving names.
- f) A history of share capital for the last three years identifying the events during such period which have changed the amount of the issued capital and / or the number and classes of shares of which it composed, together with a description of changes in voting rights attached to the various classes of shares during that time. Details should be given of the price and terms of any issue including particulars of consideration where this was other than cash (including information regarding discounts, special terms or installment payments). If there are no such issues, an appropriate negative statement must be made. The reason for any reduction of the amount of capital and the ratio of capital reductions also shall be given.
- g) An indication of the resolutions, authorizations and approvals by virtue of which the shares have been or will be created and / or issued, the nature of the issue and amount thereof and the number of shares which have been or will be created and / or issued, if predetermined.

**2. Articles of incorporation.** The following information shall be provided:

- a) Indicate the registrar and the entry number therein, if applicable, and describe the issuer's objects and purposes and where they can be found in the articles.
- b) With respect to directors, provide a summary of any provisions of the issuer's charter and bylaws with respect to: (a) a director's power to vote on a proposal, arrangement or contract in which the director is materially interested; (b) the directors' power, in the absence of an independent quorum, to vote compensation to themselves or any members of their body; (c) borrowing powers exercisable by the directors and how such borrowing powers can be varied; (d) retirement or non-retirement of directors under an age limit requirement; and (e) number of shares, if any, required for director's qualification.

- c) Describe the rights, preferences and restrictions attaching to each class of the shares, including: (a) dividend rights, including the time limit after which dividend entitlement lapses and an indication of the party in whose favor this entitlement operates; (b) voting rights, including whether directors stand for reelection at staggered intervals and the impact of that arrangement where cumulative voting is permitted or required; (c) rights to share in the issuer's profits; (d) rights to share in any surplus in the event of liquidation;
  - d) (e) redemption provisions; (f) sinking fund provisions; (g) liability to further capital calls by the issuer; and (h) any provision discriminating against any existing or prospective holder of such securities as a result of such shareholder owning a substantial number of shares.
  - e) Describe what action is necessary to change the rights of holders of the stock, indicating where the conditions are more significant than is required by law.
  - f) Describe the conditions governing the manner in which annual general meetings and extraordinary general meetings of shareholders are convoked, including the conditions of admission.
  - g) Describe any limitations on the rights to own securities, including the rights of nonresident or foreign shareholders to hold or exercise voting rights on the securities imposed by foreign law or by the charter or other constituent document of the issuer or state that there are no such limitations if that is the case.
  - h) Describe briefly any provision of the company's articles of incorporation, charter or bylaws that would have an effect of delaying, deferring or preventing a change in control of the issuer and that would operate only with respect to a merger, acquisition or corporate restructuring involving the company (or any of its subsidiaries).
  - i) Indicate the bylaw provisions, if any, governing the ownership threshold above which shareholder ownership must be disclosed.
  - j) Describe the conditions imposed by the memorandum and articles of incorporation governing changes in the capital, where such conditions are more stringent than is required by law.
- 3. Material contracts.** Provide a summary of each material contract, other than contracts entered into in the ordinary course of business, to which the issuer or any member of the group is a party, for the two years immediately preceding publication of the document, including dates, parties, general nature of the contracts, terms and conditions, and amount of any consideration passing to or from the company or any other member of the group.
- 4. Taxation.** The issuer shall provide information regarding taxes (including withholding provisions) to which shareholders in Mongolia may be subject. Information should be included as to whether the issuer assumes responsibility for the withholding of tax at the source and regarding applicable provisions of any reciprocal tax treaties between Mongolia and another country, or a statement, if applicable, that there are no such treaties.
- 5. Dividends and paying agents.** Disclose any dividend restrictions, the date on which the entitlement to dividends arises, if known, and any procedures for nonresident holders to claim dividends.

- 6. Statement by experts.** Where a statement or report attributed to a person as an expert is included in the application, provide such person's name, address and qualifications and a statement to the effect that such statement or report is included, in the form and context in which it is included, with the consent of that person, who has authorized the contents of that part of the document.
- 7. Documents on Display.** The issuer shall provide an indication of where the documents concerning the issuer which is referred to in the document may be inspected. Exhibits and documents on display generally should be translated into Mongolian, or a summary in the Mongolian language should be provided.

## **ANNEX B: DOCUMENTS REVIEWED**

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## **ANNEX B: DOCUMENTS REVIEWED**

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- Law of Mongolia on the Legal Status of the Committee on Financial Regulations, November 2006
- The Securities Market Law, December 2002
- FRC Regulation on Listing of Securities Issued for a Public Offer, September 2006
- The Companies Act, December 1999, As Amended
- The Stock Exchange Listing Regulation, November 2003
- Mongolian Stock Exchange- Fact Book 2007
- IOSCO International Disclosure Principles for Cross-Border Offerings and Listing of Debt Securities, October 2005
- IOSCO International Disclosure Standards for Cross-Border Offerings and Initial Listings, September 1998
- Annual Report 2007, BDSec JSC
- IPO Prospectus, ANOD Bank offering, April 2008



## **ANNEX C: MEETINGS**

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## **ANNEX C: MEETINGS**

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Persons consulted:

Financial Regulatory Commission, Government House IV

- Mr. D Bayarsaikhan, Chairman
- Ms B Ayush (Ph.D), Deputy Director
- Ms B Altantsetseg, Officer

Mongolian Stock Exchange, Sukhbaatar Square-2

- Mr S Davaasambuu, Senior Vice President
- Ms T Tsendmaa, Head- Listing & Surveillance Department
- L Temuulel, International Relations

City Capital Partners, Atlant Building, 201, Olympic Street

- Mr Badan Batbaatar, CFO

BDSec JSC, Empire Building

- Mr. B Lkhagvadorj, Deputy Director
- G Munkhtulga, Project Team

Mongolian International Capital Corporation (MICC), 7/2 Peace Avenue, Chingeltei District

- K Munkhzul, Vice President
- B Delgersaikhan, Analyst Capital Markets

Financial Service Corporation (FSCo), Peace Avenue 15A/5, Sukhbaatar District

- Mr Dugar Jargalsaihan, CEO
- Ms Begzjav Duka, Project Manager

ANOD Bank, Youth Avenue-21, Bayanzurkh District

- Mr O Munkhjooloo, Senior Member, Marketing Unit, Development Department

Mongolian Securities Dealers and Brokers Association, Ulaanbaatar-210351

- Mr L Tseveenravdan, Executive Director

MOSDAQ, Peace Avenue-89

Mr T Tsogtbayar, Senior Manager



## **ANNEX D: PRESENTATION SLIDES**

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## ANNEX D: PRESENTATION SLIDES

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Competitiveness Project

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### INITIAL PUBLIC OFFERINGS (IPOs) REVIEW OF REGULATIONS- PRACTICES PROCEDURES PROPOSED RECOMMENDATIONS

Cliff Kennedy  
Consultant

July 1, 2008  
Ulaanbaatar, Mongolia



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Economic Policy Reform and  
Competitiveness Project

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### Agenda

- Timing and purpose of IPO regulation and process review
- Rapid Growth of IPOs, 2005-2008 (from 2 to 12)
- Evaluation of IPO regulation, policies, procedures
  - Examination of law and regulation
  - Review of manuals, instructions, guides and websites
  - Process of IPO application and prospectus and FRC review with issuer, underwriters, MSE, FRC, others
- IPO document preparation roles of issuer, underwriters, MSE and others
- Tasks ahead and proposed recommendations



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## Mongolia's IPO regulations and guidance

- What is an IPO in Mongolia?
- What are Mongolian IPO regulations?
- Where are descriptive provisions that provide guidance and instructions for regulations found?
- How do you align revisions of IPO regulation with International best practices?
  - Consideration of IOSCO Standards
  - Consider recent EU prospectus directive
  - Examine SEC regulations and practices
  - Consider other jurisdictions
  - Expand regulation drafting approach by providing more descriptive provisions and provide guidance and instructions for regulations
- Determine approach for regulations and guidance publication



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## IPO Basics

- IPO also referred to simply as a "public offering"
- Company issues shares to the public for the first time
- Can be done by large privately-owned company selling very small percentage of shares looking to become publicly traded
- New shareholders have right to future profits distributed by company and right to capital distribution in case of dissolution.
- In addition, once a company is listed, it will be able to issue further shares via a rights issue providing itself with capital for expansion without incurring debt



## IPO Basics

- Usually issuance of new shares to raise new capital
- Can be secondary sale of existing shares by owners
- Can be regulatory restrictions and restrictions imposed by underwriter on the sale of existing shares
- IPO common methods to sell shares
- Dutch auction
- Firm commitment
- Best efforts
- Bought deal
- Self distribution



## MSE Involvement in IPO process

- MSE must review application and prospectus
- Introduce and assure compliance with MSE listing rules
- Accept or reject listing, sign contract
- Monitor sales of offering
- Protect investors and process
- Monitor required filings by listed company
- Coordinate with FRC



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## IPO Standards

- FRC member of IOSCO since 2002
- Member of IOSCO Asia Pacific Regional Committee and Emerging Markets Committee
- IOSCO Published Principles (2005) and Standards (1998) for Initial listings including extensive discussion ([www.iosco.org](http://www.iosco.org))
- SEC regulations, instructions, comment letters and website ([www.sec.gov](http://www.sec.gov))
- EU Prospectus directive adopted in most member countries- regulations and prospectuses available on websites of issuers and regulators ([www.financialregulator.ie](http://www.financialregulator.ie))
- How do Mongolian regulations and standards compare?
- All regulations and regulators require Issuer disclosure of known risks connected with the securities being offered or the issuer itself
  - Due diligence investigations required during prospectus preparation
  - Required written verification of accuracy of information contained in prospectus and application



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## Information FRC regulation requires in IPO application

- Background on the issuer of securities, type of activities, strategy, primary benchmark of production and services, information on the position of the issuer of securities in the specific market, and research (Section 2.6.1) TOO BRIEF
- Prospectus on organization of the issuer of securities, governing structure, and representative offices and unites (Section 2.6.2) TOO BRIEF
- Type and form of securities being offered (2.7.1) SHOULD BE STRAIGHT FORWARD



## Information FRC regulation requires in IPO application (Con't)

- Risk and risk analysis that may occur to investors when purchasing specific securities (2.7.14) THIS AREA WILL REQUIRE MOST WORK, COMPARE GOOGLE DISCLOSURE
- Estimation for price of offering (2.7.8) SHOULD NOT INCLUDE GOVERNMENT
- Business plan of the company (2.7.12) MUST BE MORE DETAILED
- Stock market data (2.7.5) SHOULD BE STRAIGHT FORWARD



## Information FRC regulation requires in IPO application (Con't)

- The terms of the particular offering, including type and form of securities (2.7.13) SHOULD BE STRAIGHT FORWARD
- Entitlements of the securities owner (2.7.2) SHOULD BE STRAIGHT FORWARD
- The identity and contract terms of any underwriter (2.7.17) REQUIRES INSTRUCTIONS ON UNDERWRITER COMPENSATION DISCLOSURE, RESPONSIBILITIES
- The procedure and plan to trade securities of public disclosure, including if done without an underwriter (2.7.17) THIS REQUIREMENT IS NOT CLEAR
- Information on previous issues of securities and bond information (2.7.7) REQUIRES INSTRUCTIONS REGARDING RELEVANCE



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## Information FRC regulation requires in IPO application (Con't)

- The use of proceeds (2.7.11), **REQUIRES INSTRUCTIONS AND RELATE TO BUSINESS HISTORY**, and
- Issuer financial reports of the issuer for the last three years, including complete additional explanations and clarifications specified in identified Regulations of the FRC and MOF, included with the application documents and financial report for quarter prior to the application certified by an auditing organization (2.6.5) **REQUIRES DETAILED INSTRUCTIONS TO REACH MD&A INTERNATIONAL LEVELS**



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## Application and International Standards

- The Application include information relating to the securities to be offered or listed for trading, including:
  - The identity of the people responsible for drawing up the application and securities note.
  - Key information, including a working capital statement, capitalization and indebtedness, interest of persons involved in the offer, and reasons for the offer and use of proceeds.
  - Market risk factors material to the securities being offered or listed for trading.
  - Details of the offer and admission to trading, including the plan for distribution, pricing, the markets where securities will be sold, selling securities holders, dilution, and expenses of the offering.



## Application and International Standards

- This document should contain important information relating to the issuer, including:
  - Persons responsible for the contents of this document, and a written declaration by them that the information contained therein is accurate to the best of their knowledge.
  - Key information: This includes information about the issuer's risk factors, financial condition, capitalization and other material information specific to the issuer or its industry.
  - Information on the company's business operations, its products or services, and the factors affecting the business.



## Application and International Standards (cont'd)

- Directors, senior management and employees. This section allows investors to learn about remuneration, corporate governance practices, qualifications of directors and management, and any relationships with the company.
  - Remuneration should be listed on an individual basis, unless not required in home jurisdiction and not otherwise publicly disclosed by issuer.
  - Issuers should provide information regarding the terms of office and service contracts of directors, the practices and members of the audit and remuneration committees, and a statement regarding the board's compliance with national corporate governance regimes.



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## Application/registration document (cont'd)

- Operating and financial review and prospects. This is management's explanation of the factors that have affected the company's financial condition and results of operations for the periods covered by the financial statements, and its assessment of future trends (Often referred to as MD&A)
- Major shareholders and related-party transactions. This section allows investors to learn about any major shareholders and others who may have control or influence over the company.
- Additional information not covered elsewhere.
  - Description of share capital
  - Description of the memorandum and articles of association
  - Summaries of material contracts
  - Third party information and experts' statements
  - Documents on display
  - Information on significant holdings



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## Mongolian brief prospectus

- Brief prospectus (Annex 2) should include the most important information about issuer in a few pages, in non-technical language
- Measured against international standards Brief Prospectus note MUST cover:
  - Risk factors and business summary (a risk factor must not be de-emphasized by including excessive caveats or conditions; risks disclosed in the order of seriousness from most serious to least serious)
  - Identity of directors, senior management, advisors and auditors;
  - Offer statistics and expected timetable;
  - Key information concerning selected financial data, capitalization and indebtedness, the reasons for the offer and the use of proceeds;
  - Information regarding the issuer, including its history and a business overview;
  - Research and development, patents and licenses
  - Major shareholders and related-party transactions
  - Significant changes



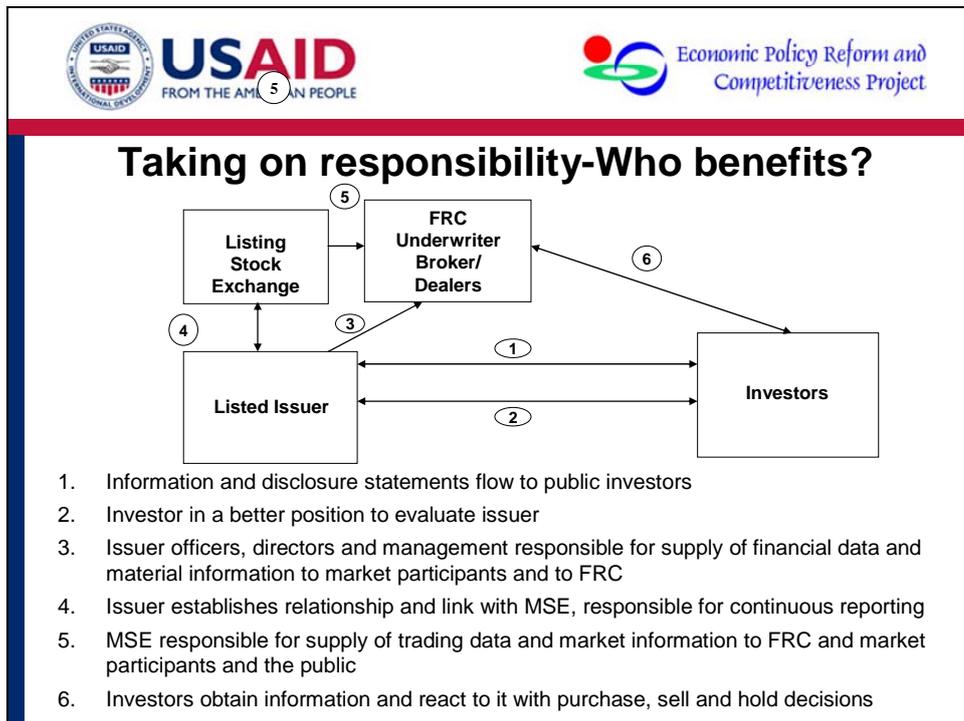
## Liability for failure to disclose- Mongolia v International standards

- Primary responsibility for disclosure rests with the issuer THIS WILL REQUIRE LAW AMENDMENT AND TIE IN TO OFFICER AND DIRECTOR RESPONSIBILITY
- However, issuer officers and directors, lawyers, accountants, underwriters, and other professionals can also be held responsible for failure to disclose material facts
  - These groups required to perform “due diligence” of the issuer and its disclosure statements to ascertain that all material facts are disclosed properly NEW CONCEPT IN MONGOLIAN MARKET, REQUIRES REGULATION, RELEASE AND INSTRUCTIONS
  - Officers, directors and professionals verify information in writing and are held responsible by regulator and investors STANDARD INTERNATIONAL PRACTICE



## Role of regulator- procedures for reviewing prospectus during preparation by issuer, professionals- at FRC, at SEC

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li>• Place yourself in the position of the buyer</li> <li>• Compare the prospectus to others in the industry</li> <li>• Compare to form requirements</li> <li>• Analyze the financial statements</li> <li>• Look for red flags                     <ul style="list-style-type: none"> <li>– Inconsistencies</li> <li>– Predictions</li> <li>– Guarantees</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>• Review risk factors and require warnings to investors as appropriate</li> <li>• Consider the need for an escrow</li> <li>• Evaluate the auditor</li> <li>• Consider the need for additional disclosure</li> <li>• THINK - don't just read the materials and compare them to form requirements!</li> <li>• TRAINING MUST BE ESTABLISHED AND MANUAL PREPARED</li> </ul> |
|---|--|



- 
- Summary of information provided by issuer-international best practices- most be clear detailed-not brief or vague**
- Full Information about the Issuer
  - Risk factors of issuer/industry
  - History and developments
  - Business overview
  - Operating and financial review
  - Profit forecasts
  - Management and shareholders
  - Financial information
  - Information about the securities
  - Risk factors of securities/market risk
  - Working capital statement
  - Capitalization and indebtedness
  - Details on securities
  - Terms and conditions of the offer



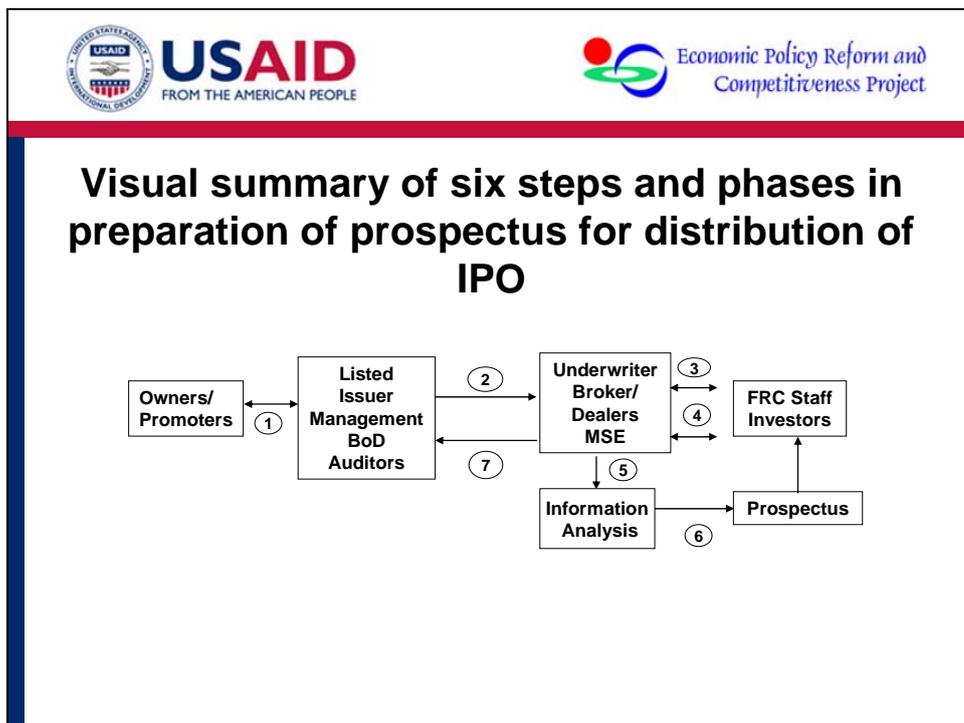
## Important brief/summary prospectus disclosure requirements

- Risk factors Includes market, industry and issuer specific risks IOSCO STANDARD
- Description of Business-Includes present and proposed activities, competition and line of business information IOSCO STANDARD
- Summary of the Offering-Includes summary of risks, issuer's business and financial results-must be in plain Mongolian IOSCO STANDARD
- Management-Includes remuneration, share ownership and related party transactions-most difficult disclosure to evaluate IOSCO STANDARD
- Financial statements must be timely, audited by an independent auditor in accordance with IAS and presented in accordance with International Reporting Standards IOSCO STANDARD
- Management's Discussion and Analysis of the Financial Statements and Results of Operations (MD&A)-Intended to explain the financial statements through the eyes of the issuer's management-to be covered separately tomorrow IOSCO STANDARD



## Material fact- disclosure required Generally-International standard

- Material fact is one that could be expected to have an impact on the market price of the shares of an issuer
- Test of materiality: Would a reasonable person attach importance to the information in determining his or her choice of investment action?
- Any facts that affect the probable future of the company and that may affect the desire of investors to buy, sell, or hold the stock of an issuer are material



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- ### What are recommended next steps?
- Revise regulations according to International Standards, including IOSCO principles
  - New regulations establish responsibilities
  - Conduct discussions regarding discussions
  - Develop and publish detailed instructions for regulations
  - Provide periodic circulars about FRC interpretations of regulations
  - Publicize on website- staff comment letters, FRC opinions
  - Establish website page for prospectuses
  - Conduct training
  - Prepare staff IPO review manual



## Proposed recommendations and tasks

- Recommendations- Revise Regulation To IOSCO Standards
- Discuss Requirements and Process with market participants, issuers, accountant/auditors, legal profession, other relevant Government Bodies- Roundtable Meetings and Discussions,
- Establish and Verify Responsibilities of all stakeholders,
- Prepare Detailed Instructions for New Application Requirements and Full Prospectus disclosure and Publish, accept comments,
- Create Websites for Prospectuses, FRC releases, statements, opinions at FRC and possible at MSE where appropriate
- Train and Retain Talent in Firms and FRC, Prepare Manuals